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RUEATRS/TREASURY DEPT WASHDC
RUEHUL/AMEMBASSY SEOUL 3706
RUEHBY/AMEMBASSY CANBERRA 2204
RUEHBJ/AMEMBASSY BEIJING 7648
RUEHBK/AMEMBASSY BANGKOK 4237
RUEHIN/AIT TAIPEI 6484
RUEHOK/AMCONSUL OSAKA KOBE 5364
RUEHFK/AMCONSUL FUKUOKA 1787
RUEHKSO/AMCONSUL SAPPORO 2604
RUEHNAG/AMCONSUL NAGOYA 0909
RUEHGH/AMCONSUL SHANGHAI 0182
RUEHHK/AMCONSUL HONG KONG 6265
RUEHNH/AMCONSUL NAHA 4200
RUEHGV/USMISSION GENEVA 3117
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UNCLAS SECTION 01 OF 02 TOKYO 002946

SIPDIS

SENSITIVE
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DEPT FOR EAP/J AND EB/OIA
USDOC FOR 4410/ITA/MAC/OJ/NMELCHER
STATE PASS USTR FOR BEEMAN, MEYERS AND DWEINER
JUSTICE FOR ANTITRUST DIVISION - CHEMTOB
TREASURY FOR IA/CARNES AND POGGI
GENEVA ALSO FOR USTR
PARIS FOR OECD

E.O. 12958: N/A
TAGS: EINV ECON EFIN JA
SUBJECT: TOKYO STOCK EXCHANGE TO INTRODUCE DEPOSITARY RECEIPTS BUT
IMPACT UNCLEAR

SENSITIVE BUT UNCLASSIFIED - PROTECT ACCORDINGLY

¶1. (SBU) The Tokyo Stock Exchange plans to introduce a system of Japanese Depositary Receipts (JDRs) starting in September 2007. The system will provide a new option for foreign companies that want to access the Japanese capital markets, but that cannot or do not wish to list their shares directly. JDRs will be domestic securities, priced in yen, with transactions settled by means of the regular Japanese clearing system. For Japanese investors seeking to internationalize their portfolios, this makes JDRs more convenient than purchasing foreign stocks directly. Both TSE and METI officials view the introduction of this new type of financial instrument in the Japanese markets as contributing to making Tokyo a more globalized financial center. Whether significant numbers of foreign companies will be interested in a JDR listing remains unclear. End Summary.

¶2. (U) Like the almost 80-year-old system of American Depositary Receipts under which shares of over 280 foreign firms trade on the New York Stock Exchange, the JDR would be a security issued by a domestic depositary bank that represents shares of a foreign corporation held by that institution, which in most cases would be an investment bank. The TSE would quote prices for and trade JDRs alongside domestic shares. Prices for the securities would be in yen and dividends paid in yen. Investors would be able to hold the securities in their domestic investment accounts and to avoid opening the special accounts and paying the additional fees required to trade and own foreign securities in Japan. In this way, the JDR represents a convenient way for Japanese investors to internationally diversify their portfolios.
¶3. (SBU) According to the Head of Product Development at the TSE Listing Department, foreign companies issuing JDRs will need to

comply with the same disclosure rules as any other TSE-listed firm. They will also need to submit financial statements, in Japanese, to the Ministry of Finance and to offer potential investors a prospectus that includes the number of depository receipts on offer and their total value. The firms must also publicly disclose any material changes, such as corrections of earnings results, via press releases or other public media in Japanese.

¶4. (SBU) Until recently, Japanese law provided no legal basis for a secondary security such as the JDR or for the Exchange Traded Fund (ETF) Beneficiary Certificates - a depositary receipt based on a foreign traded listed fund rather than an individual listed stock - that TSE plans to introduce at the same time. The crux of the problem, according to METI's Director of Industrial Finance, was that under Japan's civil code there was no way to transfer the underlying rights inherent in the foreign share to the purchaser of the depositary receipt. With the revision of Japan's Trust Law and the implementation of the new Financial Instruments and Exchange Law in September 2007, a legal basis for transfer of rights and payments between the issuer of the underlying stock the depositary institution and the ultimate beneficiary will exist. TSE has already begun discussions with a number of foreign and domestic investment banks about participating as trustees in the scheme.

¶5. (SBU) A JDR program has particular appeal to the TSE, which is looking for ways to expand its product portfolio and boost its overall profitability in advance of its expected 2009 initial public share offering. Although TSE tells us it does not need explicit approval from the Financial Services Agency (FSA) to introduce these new products, the exchange has been in consultation with the agency, which had no objection. TSE officials tell us they have found FSA officials far more receptive to the idea of new product offerings since public discussion of promoting Tokyo as a global financial center arose in recent months.

¶6. (SBU) Neither TSE nor METI officials could provide clear projections of how many foreign firms they expected to take advantage of a JDR listing. Nor could they say whether or how a JDR program would be better for a foreign firm than listing its shares directly. Although outgoing TSE President Nishimuro had told EMIN in 2006 that increasing the number of foreign companies listed on the exchange was one of his priorities, the number of TSE's foreign company listings is less than 30 today, down from a high of over 120 in the early 1990s.

¶7. (SBU) The Director of METI's Industrial Finance Division told us the most likely potential issuers of JDRs would be firms based in jurisdictions, such as India and Taiwan, which have laws explicitly prohibiting domestic companies from listing shares overseas. Medium-sized foreign companies may also find it cheaper to issue depository receipts rather than stock if the depositary bank prepares the necessary listing documentation and takes care of investor relations. Finally, some foreign firms considering the triangular merger mechanism -- a stock-swap acquisition via a subsidiary firm incorporated in Japan -- under Japan's new Company Law may chose to use JDRs instead of foreign-listed stock as consideration in the merger to make the deal more appealing to the target company's shareholders.

¶8. (SBU) Comment: In our discussions with TSE officials, there was no indication they had a clear calculation of the potential size of the JDR market. Rather they viewed an expanded menu of investment products by itself as a benefit for the exchange and for Japanese investors in general. It is unclear whether this new scheme will attract a significant number of foreign companies to list in Tokyo at a time when global capital markets are already awash in liquidity.

SCHIEFFER